



United States Coast Guard
Fiscal Year 2003 Audit
Notification of Findings and Recommendations (NFR)

Disposition: TBD
(MW, RC, ML)

NFR number: CG 03-027

KPMG Auditor: Adam McBride

Audit Area: Risk Management

Subject: Environmental Liabilities – Shore Facilities

W/P Reference: H-14 & H-12

Date: 12/3/03

Condition: Coast Guard's process for calculating the environmental liability associated with shore facilities was not fully effective. In total, there were 184 projects with an estimated liability of \$69 million. This represented 73 percent of Coast Guard total FY 2003 estimated environmental liability of \$94 million. A review of 19 projects, with an estimated liability of \$38 million, disclosed that:

- Estimates were not always based on current-year dollars: Many estimates had not changed appreciably since FY 2002, and there were no indications that indexing (such as the consumer price index, or the rate of inflation) had been applied to bring prior-year estimates to current year dollars. Of the 19 projects reviewed, Coast Guard estimated that the cost was understated by approximately \$844,000. Coast Guard further determined that updating all estimates to current year dollars for the remaining 165 projects would increase the liability by an additional \$672,000.
- There was inconsistent use of contingency factors: There are many uncertainties involved in estimating a liability for remediation considering the varying approaches of remediation that may be required and the costs of long-term monitoring for a site. This becomes even more difficult in the early stages of a project when the complete exposure and related remediation is still being evaluated. To compensate for some of these uncertainties it is not uncommon to include a contingency factor to the cost estimate, which is typically 5 to 10 percent of the estimated cost. However, the Coast Guard did not apply a contingency factor to similar cost estimates on a consistent basis. Of the 19 projects reviewed, 12 projects, with a value of \$26 million (68 percent of the value of the projects reviewed), did not appear to include a contingency factor in the estimate. Therefore, the amount of the understatement for these 12 projects could range \$1.3 to \$2.6 million. If 68 percent of the dollar value associated with the remaining 165 projects (\$21 million) does not include a contingency factor, then amount of the understatement could range from \$1.0 to \$2.1 million.
- Estimates were not based on all sources of funding: The Coast Guard only reports liabilities for projects that will be funded from the Environmental Compliance and Restoration (EC&R) Appropriation. In some cases (e.g., Kodiak Island-based projects), general operations funding was used for remediation projects. For the 19 projects reviewed, 1 project used funds other than the EC&R Appropriation. Although, the costs were not significant, the Coast Guard should determine the extent that other funding is used for environmental remediation projects.

Criteria: Statement of Federal Financial Accounting Standards (SFFAS) Number 6, *Accounting for Property, Plant, and Equipment*, paragraph 85 defines environmental cleanup costs as those costs for removing, containing, and/or disposing of (1) hazardous waste from property, or (2) material and/or property that consists of hazardous waste at permanent or temporary closure or shutdown of associated PP&E. Paragraph 88 states that these cleanup costs meet the definition of liability provided in SFFAS number 5, *Accounting for Liabilities of the Federal Government*. Paragraph 96 states that remediation estimates shall be revised periodically to account for material



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changes due to inflation or deflation and changes in regulations, plans and/or technology. New remediation cost estimates should be provided if there is evidence that material changes have occurred; otherwise estimates may be revised through indexing.

The *Federal Managers' Financial Integrity Act of 1982* requires "internal accounting and administrative controls of each executive agency shall be established in accordance with standards prescribed by the Comptroller General." GAO's *Standards for Internal Control in the Federal Government* defines internal control as "an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations." *Standards for Internal Control in the Federal Government* list five standards for internal control, to include monitoring. The standards further state "internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties."

Cause: Lack of policies or procedures, or failure to follow stated policies and procedures, resulted in different approaches by shore facility commands in calculating the environmental liability estimates.

Effect: The environmental liability associated with shore facilities was understated by at least \$2.8 million and could be understated by an additional \$3.4 million.

Recommendations: We recommend that the Coast Guard:

1. Develop and implement policies and procedures on the consistent use of indexing and contingencies in environmental estimates.
2. Develop a process to estimate the environmental liability based on the total costs for remediation, regardless of the source of funding.

Agency Response (due 5 calendar days from date of issue):

☒ Management concurs with this finding.

☐ Management does not concur with the finding.

Please indicate your response in the space provided above. Your written response will be considered when preparing the draft audit report. ***Please provide specific actions planned or taken to address the condition along with specific target dates.***

Actions Planned:

The Coast Guard plans to develop appropriate policies and guidance necessary to implement the above-referenced recommendations. The policies and guidance will be in place and effective by 01 July 2004.



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